

Docket Nos. 98-0252/0335 (Consol.)

Staff Exhibit 27.0

NONPROPRIETARY REBUTTAL TESTIMONY

OF

ROBERT KOCH

TELECOMMUNICATIONS DIVISION

ILLINOIS COMMERCE COMMISSION

AMERITECH ILLINOIS

DOCKET NOS. 98-0252/0335 (CONSOL.)

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1 **I. Introduction**

2

3 **Q. Please state your name and business address.**

4

5 A. My name is Robert F. Koch and my business address is 527 East Capitol Avenue,
6 Springfield, Illinois 62701.

7

8 **Q. Are you the same Robert Koch that filed direct testimony in this case?**

9

10 A. Yes.

11

12 **Q. What is the purpose of your rebuttal testimony?**

13

14 A. This testimony is divided into six sections. Section I is this introduction. Section II
15 responds to the direct testimony of Charlotte TerKeurst on behalf of the Government
16 and Consumer Intervenors ("GCI") as it relates to the structure of the service baskets
17 used by Ameritech Illinois' ("Ameritech" or "AI") in its alternative regulation plan.
18 Section III addresses the rebuttal testimony of Ameritech witnesses David
19 Gebhardt. Section IV addresses the rebuttal testimony of AI witness J. Thomas.
20 Section V provides further evidence concerning the impact of competitive
21 reclassification. Section VI summarizes and concludes this testimony.

22

II. GCI witness TerKeurst direct testimony

Q. Please comment on Ms. TerKeurst's proposal to discourage premature reclassification of services.

A. Ms. TerKeurst recommends three safeguards to prevent premature reclassification. First, on page 32 of her direct testimony, she recommends a \$10,000 per day fine to be imposed upon carriers that reclassify services as competitive, where such reclassifications are later found by the Commission to be improper. Second, on page 33 of her direct testimony, she recommends that the refund process be streamlined in cases where the Commission finds reclassification to have been improper. Under Ms. TerKeurst's refund proposal, actual reclassification of the improperly classified service would occur 5 days after the Commission Order rejecting the reclassification, and refunds would commence within 14 days of the Commission Order. Third, on page 33 of her direct testimony, she recommends that an earnings sharing provision be implemented.

In my direct testimony, I show that competitive reclassification has had a significant negative impact on the ability of the alternative regulation plan to effect rate reductions. Improper reclassification, therefore, should not be tolerated. Any method that discourages improper reclassification would improve the effectiveness of the Plan. The first two recommendations made by Ms. TerKeurst would definitely

45 dissuade AI from improper reclassification. The only change I would make to Ms.
46 TerKeurst's first recommendation is to more clearly define how, and under what
47 circumstances, the \$10,000 fine she proposes would be imposed. Ms. TerKeurst's
48 testimony does not make it clear whether the fine would be per service reclassified,
49 or per tariff filing that seeks to reclassify services. If it were determined that the
50 \$10,000 fine would apply to each service within the questioned filing, the penalty
51 has a potential to be rather extreme. Defining the fine to be per tariff filing would be
52 more reasonable. I concur fully in Ms. TerKeurst's second recommended
53 safeguard. A streamlined process would reduce the burden on consumers of an
54 improper reclassification.

55
56 I have concerns, however, with Ms. TerKeurst's third recommendation. Although I
57 agree with the general premise that earnings sharing would reduce the incentive to
58 reclassify services, it does not appear to me to be an appropriate remedy. Ms.
59 TerKeurst's first two recommendations would be sufficient to provide Ameritech with
60 sufficient disincentives to prematurely reclassify services. Her third
61 recommendation would be unnecessary for this purpose. Earnings sharing has
62 many implications, and is a major issue in terms of the entire structure of the Plan.
63 Staff does not recommend that earnings sharing be introduced for Ameritech Illinois
64 for various reasons that have nothing to do with its ability to dissuade improper
65 reclassification of services.

Q. Please elaborate as to why you believe that imposing a \$10,000 fine per day per service would be unduly burdensome on Ameritech Illinois.

A. The following example illustrates why it is more appropriate to charge the \$10,000 fine for the entire filing, and not for each individual service in the filing. If there were 50 services in the tariff filing, then the penalty would be \$500,000 per day. Under the best of circumstances, an extraordinarily expedited proceeding would last a minimum of 2 months to the date of the Final Order. Ameritech would then have to pay over \$30 million in fines. Docket No. 98-0860 presents an example of what might result if there were delays. That proceeding is a rate reclassification case which has been pending for over two years. Were fines based on \$10,000 per day per service, in the event that Ameritech's reclassification is found improper, it would be subject to fines exceeding \$365 million.¹

In the alternative, if the \$10,000 fine were imposed on the filing as a whole, a case litigated for 2 years would only result in fines of \$7.3 million. Fines of this magnitude would provide some incentive for Ameritech to file only those reclassifications that could be defended, as well as expedite any proceeding that did occur. At the same time, such fines would not be confiscatory or unreasonable

¹ No Hearing Examiner's Proposed Order has been entered in Docket No. 98-0860 to date.

87 **Q. Ms. TerKeurst claims that the Commission established a “cap” on rates for**
88 **switched access in I.C.C. Docket No. 97-0601/0602 (Consolidated). Is this**
89 **your understanding of the Commission Order?**

90

91 A. Yes. Ms. TerKeurst cites pages 47-53 of the access reform order to support her
92 claim. In fact, the order sets the rate cap equal to the LRSIC for the service plus
93 28.86%. In my direct testimony, however, I had improperly interpreted the access
94 reform order as requiring that prices be set exactly equal to cost. Therefore, I
95 erroneously concluded access charges could not be reduced in the price cap plan.

96

97 **Q. Have you changed your recommendations for the Carrier Basket since the**
98 **filing of your direct testimony.**

99

100 A. Yes. In my direct testimony, I recommended that access charges be removed from
101 the Plan, wholesale services be moved to the Other Services Basket, and that the
102 Carrier Basket be eliminated. These recommendations were based on the
103 erroneous belief that the Order in I.C.C. Docket No. 97-0601/0602 (consolidated)
104 restricted access charge rates and that the API of the Carrier Basket was too low to
105 effectuate rate decreases. As stated above, my understanding of the access
106 reform order has changed. Since access charges could be reduced (to the level of
107 their LRSICs) without being in violation with the access reform order, I no longer
108 recommend that they be removed from the Plan.

109

110 Further, if the Commission were to follow my recommendation to reset the APIs and
111 the PCI to 100, the Carrier Basket would become able to effectuate rate changes in
112 annual filings. Therefore, I no longer recommend that the Carrier Basket be
113 removed from the alternative regulation plan or that wholesale services be moved to
114 the Other Services Basket.

115

116 **Q. Has your position changed regarding UNEs, Interconnection, and Transport**
117 **and Termination?**

118

119 A. No. My position on these services has remained unchanged. UNEs,
120 Interconnection, and Transport and Termination should continue to be excluded from
121 the Plan. Unlike access charges, the Commission has previously decided that
122 these services are priced outside of the Plan and should be excluded from the
123 alternative regulation plan. I am not convinced by Ms. TerKeurst's arguments for the
124 inclusion of these elements in the Plan.

125

126 **Q. Has your position regarding the removal of the Business Basket changed**
127 **as a result of your review of Ms. TerKeurst's recommendations?**

128

129 A. Yes. In addition to changing my position regarding the removal of the Carrier
130 Basket, my position in regard to the removal of the Business Basket has also

131 changed. In direct testimony, I recommended that the remaining services in the
132 Business Basket be consolidated into the Other Services Basket if the Commission
133 decides that the services in Docket No. 98-0860 are not to be reclassified as
134 noncompetitive. Although the Business Basket currently contains virtually no
135 services, there is potential that Ameritech will introduce new business services that
136 would most appropriately be in the Business Basket. Also, Staff may challenge
137 other competitive business service reclassifications in the future. I believe that
138 keeping the Business Basket intact would facilitate proper placement of new or
139 reclassified business services in the alternative regulation plan on a going-forward
140 basis, regardless of the outcome of Docket No. 98-0860.

141
142 **Q. Please summarize the revisions to the service baskets you are proposing in**
143 **your rebuttal testimony.**

144
145 **A.** In my direct testimony, I recommended that the Carrier Basket be removed from the
146 Plan, and I also recommended that, if the Order in Docket No. 98-0860 does not
147 require that business services be returned to the Plan, that the Business Basket
148 also be removed. I no longer recommend that either service basket be removed
149 from the Plan under any circumstance. Further, I now recommend that access
150 charges and wholesale services remain in the Carrier Basket.

151 **III. AI witness David Gebhardt**

152
153 **Q. Mr. Gebhardt asserts that your statements concerning AI overstating the**
154 **benefit of the Plan actually demonstrate that customers benefited more than**
155 **he had previously stated. (AI Exhibit No. 1.3 at 9). Is this correct?**
156

157 **A.** No. Mr. Gebhardt appears to be using the term “consumer benefit” in his rebuttal
158 testimony to mean something other than what he used the term to mean in his direct
159 testimony. In his direct testimony, Mr. Gebhardt quantifies the consumer benefit by
160 examining the revenue reductions that have occurred over the life of the Plan in
161 response to Issue 5. This revenue reduction was calculated by applying price
162 reductions to existing demand.

163
164 As I stated in my direct testimony, this method of calculating the revenue reduction is
165 flawed. By Mr. Gebhardt’s own admission, Ameritech targeted rate reductions to
166 services whose demand would be stimulated as a result. (AI Exhibit No. 1.0 at 14).
167 Since this demand stimulation was not a part of the calculation, Mr. Gebhardt
168 overstated the revenue reductions in response to Issue 5. Thus, by ignoring
169 demand stimulation, the consumer benefit claimed through reduced revenues is in
170 fact overstated. In fact, decreasing the price of a service that is highly price elastic
171 will have the effect of increasing revenues for the service.
172

Q. Could you provide an example of how Ameritech overstated revenue reductions in the Plan?

A. Yes. In the 1999 Annual Filing, Ameritech decreased several residential usage rates. The Company lowered a Band A off-peak initial minute rate by 3.85%, from \$0.0312 to \$0.03. Accompanying this price decrease was an increase in demand for this service by 17.22%, from [REDACTED] minutes in 1998 to [REDACTED] minutes in 1999. The price elasticity of demand is defined as the percentage change in quantity over the percentage change in price. Any price elasticity greater than 1 is considered "elastic." That is, consumers respond favorably to rate decreases and negatively to rate increases. For the services in this example, the price elasticity is 4.48, which is highly elastic.

Using Ameritech's method of calculating "consumer benefit", the price decreases resulted in a revenue reduction of \$[REDACTED]. However, factoring demand stimulation has a dramatic effect on "consumer benefit." Using the actual 1999 demand on the price change, revenues did not decrease but rather increased significantly due to the 17.22% increase in demand. The revenue increase to the Company is actually \$[REDACTED]. Therefore, if we define the consumer benefit as the revenue reduction to consumers as a result of price decreases, and factor in demand stimulation, the Company overstated the benefit by \$[REDACTED] for this one service in MSA 1 in 1999.

195

196 **Q. Do you have any other problems with Mr. Gebhardt's criticism of your claim**
197 **that consumer benefits are overstated?**

198

199 A. Yes. I am puzzled by Mr. Gebhardt's claim that there is an increase in social welfare
200 as a result of the Company's choice to reduce prices for its most elastic services. If
201 Mr. Gebhardt could define what he means by social welfare and show proof that this
202 has actually increased, his statement would be entitled to more credence. In terms
203 of simple economic theory, social welfare is defined as the sum of the benefit
204 derived from consumers in a market plus the benefit derived by producers in the
205 market.

206

207 Since revenue reductions have been mandatory and Ameritech chose the services
208 for which rates were reduced, any claim that social welfare has improved as a result
209 of its choice must be in comparison to alternative choices. There are hundreds of
210 services in most baskets to choose from. However, if we narrow the comparison
211 between services that were chosen for reductions and less elastic services, the
212 results would yield some evidence as to whether the reductions resulted in a net
213 social welfare benefit. Without actually taking samples of services, a determination
214 of whether social welfare has been increased cannot be made. As I mentioned
215 previously, if social welfare is defined as the total benefit to consumer and
216 producers, some logical conclusions can be derived.

217

218 Ramsey pricing is the term coined for targeting rate reductions to the most elastic
219 services. Ramsey pricing essentially maximizes producer welfare in a market where
220 one firm dictates its own price. Simple economic theory dictates that consumer
221 welfare will necessarily decrease and producer benefit will necessarily increase
222 when Ramsey pricing is implemented. The total benefit, social welfare, may
223 increase as a result, but it also may decrease. Even if social welfare increases, it is
224 still a policy issue as to whether the increase in social welfare is in the public
225 interest.

226

227 **Q. Mr. Gebhardt suggests that high overall earnings are not a sign that the Plan**
228 **has had results excessively favorable to the utility. (AI Exhibit No. 1.3 at 19-**
229 **20). Please comment.**

230

231 **A.** Mr. Gebhardt suggests that since earnings for noncompetitive services are not high,
232 there is no justification to examine the terms and conditions of the Plan.
233 Unfortunately, Mr. Gebhardt restricts his examination to the impact of the inflation
234 factor and productivity offset only. If noncompetitive earnings were not too high, then
235 it would be reasonable to state that these factors would not be of concern. I am not
236 in a position to offer an opinion as to whether noncompetitive earnings are
237 appropriate. Staff witness Judith R. Marshall addresses earnings for

noncompetitive and competitive services in her direct (Staff Exhibit No. 4) and
rebuttal testimony (Staff Exhibit No.18).

Mr. Gebhardt does not examine the effect of all aspects of the Plan on overall
earnings to draw his conclusion. Since overall earnings are very high, and
noncompetitive services do not contribute to this result, one must conclude that the
company is gaining considerably in its competitive service markets. Economic
theory suggests that a competitive marketplace would put downward pressure on
prices to the point where excess profits approached zero. The exact opposite result
has occurred. A logical conclusion is that services are being declared competitive
prior to sufficient pressure in the marketplace existing with respect to those services
to replace regulatory oversight. Therefore, high earnings indicate that the Plan is
deficient due to the premature reclassification of services, which has resulted in
increased rates.

**Q. Mr. Gebhardt criticizes the “draconian” penalties recommended by Ms.
TerKeurst to reduce AI’s incentive to improperly classify services as
competitive. Please comment.**

A. I agree with Mr. Gebhardt's belief that these penalties are stringent. However, in my
opinion, there is a need for penalties to be stringent, due to the benefit Ameritech
derives from lengthy competitive reclassification cases. As mentioned in the

previous section, I support strong penalties for improper classification in the
absence of a better way to deal with the problem.

**Q. Mr. Gebhardt claims that price regulation neither encourages nor
discourages competition. (AI Exhibit No. 1.3 at 31-33). Please comment.**

A. Price regulation does not, in itself, promote competition. The absence of significant
price regulation for competitive services can stimulate competition through price
increases, though. Also, it is possible for an alternative regulation plan to promote
competition if it gives an incentive for the regulated company to open up its markets.
The current plan does not provide incentives for Ameritech to do so. The plan
allows for the transition to competition through its lack of restrictions on services
leaving the Plan.

**Q. Mr. Gebhardt claims that services that are priced at LRSIC or TELRIC with a
common overhead allocation reflect productivity gains. Please comment.**

A. I disagree with this assertion. I believe that properly calculated LRSIC or TELRIC
costs will account for some of the Company's productivity gains. However, AI has
submitted cost studies that indicate that costs are increasing for its services, which
is contrary to the generally accepted fact that telecommunications is a declining cost
industry. Further, common costs are allocated subjectively and do not necessarily

reflect productivity gains. Also, as was mentioned previously in this rebuttal testimony, I have changed my position concerning the ability of access charges to be reduced below the TELRIC plus shared and common costs.

Q. Please comment on Mr. Gebhardt's criticisms concerning reinitializing the API and PCI.

A. Mr. Gebhardt cites two reasons why the API and PCI should not be reinitialized. First, he believes that if the API were reinitialized to 100, pricing headroom that the Company has accumulated over the course of the Plan would be eliminated. (AI Exhibit No. 1.3 at 89). This, Mr. Gebhardt asserts, would be akin to penalizing AI for reducing rates more than necessary. I disagree with Mr. Gebhardt's assessment. The API for every basket, except the Carrier Basket, has been set just below the PCI in each annual filing. There have been no required rate reductions in the Carrier Basket since its API dramatically fell due to access charge reductions prior to the 1998 Annual Filing. Therefore, there is no accumulated pricing headroom for most baskets. Further, Mr. Gebhardt characterizes this "headroom" as being attributed to its previous excessive rate reductions. However, the record in this case shows that Ameritech has only reduced rates by as much as has been required. My direct testimony elaborates on this extensively.

303 Second, Mr. Gebhardt feels that reinitializing rates will have the effect of making
304 future evaluation of price changes in the Plan more difficult. (AI Exhibit No. 1.3 at
305 90). Mr. Gebhardt claims that widely used indexes like the CPI and GDPPI are
306 rarely reinitialized for the same reason. I strongly disagree with this reasoning. The
307 API and PCI are practically useless measures of examining the price changes that
308 have occurred in the Plan. This is because, unlike the CPI and GDPPI, the service
309 baskets change on a consistent basis. Looking at the API and PCI alone, one
310 would conclude that Ameritech's prices have decreased by more than 13% overall
311 since the inception of the Plan. This is a conclusion that no one, including
312 Ameritech, has tried to advance. New services have been included in the Plan and
313 other services have been removed from the Plan. The impact of competitive
314 reclassification must also be examined. It is also instructive to note that the base
315 year for the GDPPI has changed twice since the inception of the Plan. Similarly, the
316 basket structure of the CPI has changed since the inception of the Plan. Although
317 these changes are not the same as reinitializing the index, they have similar effects
318 in terms of making historical trends difficult to assess. Therefore, Mr. Gebhardt's
319 reasoning here does not have significant merit.

320
321 **Q. Please respond to Mr. Gebhardt's criticisms concerning your view that**
322 **calling plans should not be considered new services under the Plan.**
323

324 A. Mr. Gebhardt uses FCC price cap definitions to argue that a restructured service
325 should be considered a new service. Although FCC rulings concerning new
326 services in price cap plans may prove useful by our Commission in developing its
327 own rules, the Plan as adopted for AI in Illinois does not depend on these rules. Mr.
328 Gebhardt does not give any reason in his rebuttal testimony why the Commission
329 should rely on FCC decisions in this regard. Further, using the FCC rules as quoted
330 by Mr. Gebhardt, optional Centrex and ValueLink services introduced by Ameritech
331 would necessarily need to be considered new services. As these are new services,
332 Ameritech would have to follow the same criteria as existing services for
333 competitive declaration. However, it has been my experience that Ameritech has
334 introduced several options for Centrex and ValueLink under its competitive tariff
335 without applying these criteria. Neither Staff nor Ameritech address competitive
336 classification criteria in evaluating these filings because they are restructured
337 options of existing competitive services, and not new services in themselves.
338 Apparently Ameritech feels that it can apply this logic subjectively, when it suits its
339 needs.

340
341 Mr. Gebhardt asserts that there are significant administrative problems with
342 introducing new services into the Plan that applying the FCC approach would avoid.
343 (AI Exhibit No. 1.3 at 91-92). However, Mr. Gebhardt lists only one such problem.
344 He states that a new calling service could not be integrated into the Plan
345 immediately since it has no demand and would have no impact on the API. Mr.
346 Gebhardt states that using the FCC approach would avoid this problem but does

not elaborate on why this is so. I am assuming that Mr. Gebhardt reasons that, since new services are excluded from the Plan for one filing, the lack of demand would not be an issue. Since there would be no impact on the API in either case, there does not seem to be a problem to begin with. Demand forecasts are not used for restructured or new services when they are introduced into the Plan.

Q. Mr. Gebhardt states that Staff's concerns regarding placing residence calling plans in the Other Services Basket are misplaced. (AI Ex. No. 1.3 at 92). Please comment.

A. Mr. Gebhardt asserts that the Commission's objective in placing some residential services in the Other Services Basket was to partition discretionary services from basic services. Mr. Gebhardt, however, does not cite any place in the Alt. Reg. Order where this objective is stated. Therefore, I am left to surmise that this is merely Mr. Gebhardt's assessment of what the Commission's objective was in the Alt. Reg. Order. Regardless of what the Commission's objective concerning partitioning of residential services has been, I cannot accept Mr. Gebhardt's characterization of calling plans as being discretionary. Usage services, of which these calling plans are a subset, are basic services in all cases. Just because customers may choose a calling plan to obtain these basic services does not change the fact that usage is a basic service. If it were guaranteed that all consumers choosing a calling plan would always receive lower rates than under the

standard rates, then I would concede that no protection against discrimination is needed for these customers. However, this is not always the case. The allegations made by the Citizens Utility Board, which formed the basis for its complaint regarding Ameritech's marketing of its calling plans in ICC Docket No. 00-0043, suggests that consumers may not always save under calling plans and that protection is still needed.

Viewing calling plans as discretionary has significant negative impacts on consumers. First, if the ability to choose a calling plan results in those plans being characterized as discretionary, then logic would dictate that standard calling rates must also be considered discretionary. Therefore, it would follow that all residence usage services should be placed in the Other Services Basket. In following such logic, all protection against discrimination for basic residential services would be lost. Second, allowing calling plans to be introduced in the Other Services Basket has been harmful to consumers. I discuss this in depth in my direct testimony.

Continuing to keep calling plans in the Other Services Basket, or granting Ameritech's proposal to combine all services into one basket, would only increase the harm to consumers.

387 **IV. AI witness J. Thomas O'Brien**

388

389 **Q. Please comment on Mr. O'Brien's claim that increased pricing flexibility is**
390 **needed under the Plan.**

391

392 A. Mr. O'Brien asserts that increased pricing flexibility is needed because competition
393 has increased during the Plan and is growing vigorously. (AI Exhibit No. 3.1 at 10).
394 This assertion has no merit for two reasons. First, the state of competition is not a
395 factor for services contained in the Plan because they are noncompetitive services.
396 Under the current terms of the Plan, as soon as some form of competition for a
397 service exists, Ameritech reclassifies the service as competitive and gains
398 automatic pricing flexibility.

399

400 Second, Ameritech has complete flexibility in the existing plan to lower rates if there
401 are instances where it is concerned with losing market share to competitors for a
402 service that it did not want to reclassify as competitive. This downward pricing
403 flexibility allows Ameritech to reduce the rate for any noncompetitive service all the
404 way to its LRSIC regardless of whether it is in the Plan or not, and can do so at any
405 time during the year. In fact, there is no rule within the Plan itself that keeps the
406 Company from predatory pricing. Only cost of service rules that apply to all
407 companies provide safeguards against predatory pricing.

408

Q. Mr. O'Brien has offered two alternatives to its pricing flexibility proposal in his rebuttal testimony. Please comment on these proposals.

A. I listed several concerns regarding the original increased flexibility proposed by AI in my direct testimony. (AI Exhibit No. No. 3.1 at 11). Mr. O'Brien reduces the amount of proposed pricing flexibility in both of his alternate proposals to address my concerns. In doing so, AI has validated my concerns. Having said this, the next two paragraphs address the new proposals.

The first alternative is that Ameritech will limit its upward pricing flexibility to 5% if its rate rebalancing proposal is accepted. Mr. O'Brien states that less upward pricing flexibility would be needed if the rebalancing proposal were accepted. Although this revised proposal seems to be a significant compromise, it would still give the company the ability to exercise Ramsey pricing. The Plan's current upward pricing flexibility is limited to 2% plus the percentage change in the PCI. Since the PCI has been decreasing by roughly 2% every year, there has been no upward pricing flexibility. Therefore, the revised AI proposal would allow significant rate increases for noncompetitive services, which have not had any increases since the Plan's inception. Further, this reduction in the proposed pricing flexibility would require a large increase in residential rates through the rebalancing proposal. I conclude that this proposal would still be very harmful to AI's most vulnerable customers.

The second alternative is contingent on the rate rebalancing proposal not being accepted by the Commission. Under this alternative, the upward limit on pricing flexibility would be 10%, with a 30% limit over the next five years for any individual service. With this alternative, Mr. O'Brien is admitting that 10% pricing flexibility would allow AI to rebalance its noncompetitive services sufficiently. As with the first alternative, and the original proposal, there are serious concerns for consumers of AI's least competitive services.

Q. Please comment on Mr. O'Brien's claim that a single basket will not lead to discrimination against different classes of customers.

A. Mr. O'Brien misinterprets the meaning of customer class discrimination in the context of the Plan. He states that class discrimination currently exists between basic residential service and other services, and that combining baskets would lead to eliminating such discrimination. (AI Exhibit No. 1.3 at 12). In the context of the Plan, however, customer class discrimination occurs when a specific class does not receive the rate reductions given to other classes. To avoid such discrimination, residential, business, and carrier services were put in separate baskets. Therefore, when rate reductions are required in an annual filing, each customer class receives similar benefits. Any combining of service baskets eliminates the protection that certain customers currently receive. As Mr. O'Brien states, combining the baskets and allowing greater upward pricing flexibility will lead to rate increases for

residential customers. If overall rate reductions continue to be required as they have been in every annual filing to date, residential customers would not benefit at all.

This is exactly what is meant by discrimination.

Residential rates have been frozen in the current plan. Therefore, the price differentials that exist between basic residential and business customers are a result of AI continuously choosing not to lower business access line rates in annual filings and by AI choosing to declare these services competitive. If AI is truly concerned about rectifying the differential between basic business and basic residential rates, it can lower business rates. As long as the business services are priced above LRSIC, there is no restriction on the Company to lowering these rates to be more inline with residential rates.

Q. Mr. O'Brien provides a revised calculation of the API for the combined service basket proposed by AI. (AI Exhibit No. 3.1 at 16). Do you have any objections to this calculation?

A. No. The original calculation of the API for the combined service basket was performed by witness Theresa Larkin in her direct testimony, AI Exhibit No. 3.0. I identified two problems with the calculation of this new API and offered a revised calculation. The first problem I found was that the calculation of the new API by Ameritech incorrectly identified the revenue and API for each service basket as

475 coming from the April 1, 2000 Annual Filing. Upon inspection, some of these
476 figures did not match those filed by the Company on April 1, so I replaced them in
477 my calculation. In his rebuttal testimony, Mr. O'Brien identifies the changes to
478 revenue and API as occurring in the July compliance filing. He has offered
479 Schedule 2 to AI Exhibit No. 3.1 to show the calculation of the new API based on his
480 revised figures. I have reviewed this schedule and found that these revised figures
481 accurately reflect the July compliance filing.

482
483 The second problem I found with Ms. Larkin's calculation of the new API is that it
484 used revenues from services Ameritech is proposing to remove from the Plan. I
485 removed the revenue from these services in the calculation I performed in direct
486 testimony. Mr. O'Brien's calculation properly uses the method that I recommended.
487 Therefore, I have no objection to the revisions offered by Mr. O'Brien in Schedule 2
488 to his rebuttal testimony.

489
490 **Q. Do you have any concerns with the calculation of the API of the combined**
491 **service basket?**

492
493 **A.** Yes. Although the revisions proposed by Mr. O'Brien are correct, the appropriate
494 API of the combined service basket should be set at 100, in conjunction with
495 resetting the PCI at 100. I only offered my calculation in direct testimony in case the
496 Commission has chosen not to reinitialize the API and PCI.

497

498 I am troubled by Ameritech's continuing practice of using API values that have
499 changed since the most recent annual filing without providing the source of the
500 changes. My use of the API and revenue values in my calculation of the API of the
501 combined service basket is a case in point. I do not review every tariff filing made
502 by AI during the course of a year. Likewise, it would be impractical for me to verify
503 all changes to Ameritech's API when it does not match up with those provided in the
504 annual filing. As a result, I was not aware of the source for Ameritech's API and
505 revenue figures used to calculate the new API until reading Mr. O'Brien's rebuttal
506 testimony. In the case of this proceeding, it has only meant that a simple verification
507 of the July compliance filing was necessary. However, AI's annual filings are set on
508 a short schedule with no opportunity for rebuttal. When this same problem has
509 occurred in past annual filings, I have not been able to give the API numbers a
510 proper review. As I proposed in direct testimony, there should be safeguards
511 against this practice.

512

513 **V. The Impact of Competitive Reclassification**

514

515 **Q. In your direct testimony, you mentioned that a more complete analysis of**
516 **competitive reclassifications might be included in your rebuttal testimony.**
517 **(Staff Exhibit No. 14.0 at 29). Have you been able to obtain the necessary**
518 **data to provide a complete analysis of competitive reclassifications?**

519

520 A. No. As was mentioned in my direct testimony, Staff Data Request RFK 5 was sent
521 to AI for the purpose of obtaining more detailed information concerning competitive
522 reclassifications. At the time of filing this rebuttal testimony, AI has only partially
523 responded to this data request due to its late filing and the comprehensive nature of
524 the request. In the data request, I asked for separate spreadsheets containing a
525 detailed revenue impact for each of AI's competitive reclassification filings. I am not
526 entirely certain of the number of competitive reclassification filings that have
527 occurred since the inception of the Plan, but I do know that the number exceeds 20.
528 At this time I have only received responses for four of these filings: Advice No. 5096
529 (effective January 24, 1995), Advice No. 5207 (effective July 28, 1995), Advice No.
530 5344 (effective March 18, 1996), and Advice No. 5940 (effective July 14, 1998).

531

532 **Q. Did you find any significant results in the partial data request response from**
533 **AI?**

534

A. Yes. The following are a list of results that provide some insight, however incomplete, into the pricing behavior for services that have been removed from the Plan:

?? There are no services in any of the filings for which the current rate is lower than when it was declared competitive.

?? The only rate reductions were for a small subset of business Band C usage services declared competitive in Advice No. 5096. These reductions were short lived and Ameritech has subsequently increased each of these rates.

?? There were significant revenue increases for each filing after reclassification. There was also a significant overall increase in competitive revenue for the Company as a result of these four filings. The following table shows the percentage increase in annual revenue for each filing from the year prior to the competitive declaration to 1999, as well as the total amount of revenue accrued since the competitive declaration for each filing. Note that data for the year 2000 was not available and would have the effect of increasing these figures.

Advice No.	Year Declared	Revenue Prior to Declaration	Revenue in 1999	% Increase In Rev	Competitive Rev Through 1999
5096	1995	\$	\$	57.34%	\$
5207	1995	\$	\$	1776.06%	\$
5344	1996	\$	\$	67.04%	\$
5940	1998	\$	\$	168.05%	\$
Total					\$

Q. Where you able to develop a figure for the revenue impact of rate increases in any filings included in AI's response to Staff Data Request 5?

554 A. Yes. Unfortunately, there are many complications with developing such numbers for
555 most filings due to the effect of demand elasticities, the large and varied number of
556 rate changes, and other factors. I was able to develop an estimate for the impact of
557 competitive rate increases for Advice No. 5940, which declared directory
558 assistance service competitive for both residential and business customers. The
559 rate for both residential and business directory assistance was \$0.30 at the time
560 they were declared competitive in 1998. Both of these rates increased to \$0.55 in
561 1998 and to \$0.95 in 1999.

562
563 These rate increases did not change demand significantly for either service.

564 Therefore, I was not concerned with the effect of demand stimulation on my revenue
565 analysis. Applying these rate changes to the 1998 and 1999 demand showed that
566 revenue increased by approximately \$[REDACTED] as a result of reclassification.

567 This figure does not take into account that the revenue would be subject to
568 approximately 2% decreases annually if they were in the Plan. As with the table
569 above, no data for the year 2000 was available. The impact would be significantly
570 higher than \$[REDACTED] if these two factors were taken into account.

571 **VI. Conclusion**

572

573 **Q. Please summarize your rebuttal testimony.**

574

575 A. As a result of reviewing the testimony of other witnesses in this proceeding, I have
576 chosen to revise my recommendations concerning the structure of service baskets
577 in the Plan. I now recommend that all four service baskets remain intact. I also
578 recommend that access charges and wholesale services remain in the Carrier
579 Basket. The remainder of the recommendations put forth in my direct testimony
580 remain unchanged. Specifically, I am not persuaded by the testimony of other
581 witnesses against the resetting of the service basket APIs and the PCI to 100, nor
582 the arguments against moving local calling plans from the Other Services Basket to
583 the Residence Basket. This rebuttal testimony has also provided some additional
584 evidence concerning the impact of competitive reclassification. Although admittedly
585 not comprehensive, this evidence shows that the competitive reclassification has
586 been significant.

587

588 **Q. Does this conclude your rebuttal testimony?**

589

590 A. Yes.